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C O N F I D E N T I A L SECTION 01 OF 03 DUBAI 000530

SENSITIVE
SIPDIS

DEPARTMENT FOR NEA/FO; NEA/ARP/BMCGOVERN; TREASURY FOR NATASHA
ZAMECNIK

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TAGS: [ETRD](#) [KIPR](#) [EFIN](#) [ECON](#) [PREL](#) [AE](#)
SUBJECT: DUBAI SOVEREIGN VERSUS COMMERCIAL DEBT

REF: A. A) ABU DHABI 1114
[B](#). B) DUBAI 516
[C](#). C) DUBAI 491

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CLASSIFIED BY: Justin Siberell, Consul General.
REASON: 1.4 (b), (d)

1.(C) SUMMARY: In the aftermath of the November 25 Dubai World debt restructuring announcement (Ref A), Government of Dubai officials have sought to differentiate sovereign debt - those guaranteed by the Emirate - from commercial debt subject to market terms. In so doing, the Dubai government is determined to preserve sovereign assets by distancing the government from any obligation to repay debts incurred by Dubai's government-related "private" companies, like Dubai World. The government is also determined to ensure that Nakheel "sukuk" holders, particularly foreign hedge funds, understand that the December sukuk (Islamic bond) is tied to a particular asset (land). Default, therefore, should it occur, would not entitle holders of the sukuk, which matures December 14, to lay claim to other more-valuable Dubai World assets. Negotiations with creditors to extend debt maturity deadlines are proceeding favorably for Dubai World, according to senior government officials. They continue to stress their active interest in helping Dubai World manage its difficult restructuring effort, in part because of the Dubai government's role as a significant shareholder and also out of recognition that an orderly restructuring of Dubai World is in the best long-term interest of Dubai and the UAE. END SUMMARY.

DUBAI GOVERNMENT NOT LIABLE FOR DUBAI WORLD

[2](#). (C) Dubai government officials have been publicly explaining Dubai World's unexpected November 25 announcement seeking a standstill on payments on its USD 26 billion debt by differentiating "commercial" debt from Dubai's sovereign (and therefore guaranteed) obligations (Ref B). This effort seeks to disabuse investors of any notion that the Dubai government had ever been a guarantor of these debts as many investors had believed. (Note: According to a recent Barclays report, Dubai sovereign and quasi sovereign debts that are publicly guaranteed total USD 17.6 billion. The remaining USD 69.5 billion is thought not to be guaranteed by sovereign pledges and includes a substantial albeit undisclosed portion of Dubai World debts. End Note) The list of sovereign and quasi-sovereign assets that the government would presumably guarantee include Emirates Airlines, Dubai Civil Aviation Authority, Dubai Electric and

Water Authority, Dubai Aluminum Company, Dubai Ports World and Dubai Holding, Dubai Ruler Sheikh Mohammed Bin Rashid Al Maktoum's stable of personally owned assets.

13. (C) In a December 8 meeting with Ambassador and Consul General, Mohamed Shaibani, Chief of the Dubai Ruler's Court, and the individual at the center of the government's attempts to deal with the debt crisis, said that the priority of the Dubai government was to "protect sovereign assets". A clear line would be drawn between assets owned/backed by the government and those of the private, government-associated companies like Dubai World. Similarly, Dubai Department of Finance Director General Abdul Rahman Al Saleh and Director of Funds Management Marwan Abedin told the Consul General and Econoff on December 6 that the government would continue to take an active interest in helping Dubai World manage its restructuring effort, but would not be liable for its debts. In this regard, and in a possible foreshadowing of government intent, Shaibani pointed to USG support for companies viewed as critical to the long-term health of the U.S. economy, noting specifically the auto manufacturers. Saleh held that investors "did not do their homework" to properly assess the risk of investing in Dubai World and Nakheel, despite the presence of explicit disclaimers in Nakheel's sukuk prospectus, he said.

GOVERNMENT WILL MEET ITS DEBT OBLIGATIONS

14. (C) At the same time, Al Saleh emphasized that the Dubai Government will honor its sovereign debts and has taken

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necessary steps to ensure it is in a position to meet all future obligations. (Note: The Government of Dubai successfully sold USD 1.9 billion in five year Islamic Sukuk bonds in November as part of a USD 6.5 billion bond program (Ref B). The bond sale, although it preceded the Dubai World debt standstill announcement, was the biggest Sukuk sale from the Gulf region this year End Note.) Saleh insisted that all publicly guaranteed Dubai Government entities such as Dubai Civil Aviation Authority and Dubai Electric and Water Authority have the full protection of the Emirate's sovereign guarantee and that the government has sufficient revenue to meet those needs. Al Saleh did concede that in the short-term the Dubai Government will face difficulty in raising funds through capital markets, but remained optimistic about long-term fund-raising prospects (Comment: Saleh is exceedingly optimistic on this point in our view End Comment.)

15. (C) Al Saleh identified the government's recent payment of a USD 1 billion Dubai Civil Aviation Authority bond as proof that the Emirate was fiscally sound and on track to meeting its sovereign debt obligations. Abedin noted that once the Dubai Government completed critical infrastructure projects such as the metro rail, government funds committed to this effort would be freed up and eventually would generate sufficient funds to help meet future debts and to fund future investment. In response to the question where Dubai might find additional revenue to help service government obligations, Saleh said that Dubai would continue to advocate for a federal Value Added Tax (VAT) system. Implementation of a UAE VAT was being discussed at senior levels of government, he said, but would hinge also on whether the UAE was prepared to move forward alone or only as part of a GCC-wide decision.

LOOMING DISPUTE OVER SUKUK TERMS?

¶6. (C) Shaibani told Ambassador and Consul General that Dubai World was having some success negotiating a restructuring of Nakheel's sukuk obligations with bank holders of that debt, in particular the Dubai-based banks most exposed to Dubai World debt. (Note: Numerous sources claim that roughly 75 percent of Dubai World's debt is held by UAE banks. End note.) Dubai World faced an aggressive community of sukuk holders within the hedge fund community, however, who were pushing for default in order to lay claim to Dubai World assets, he said. Shaibani held that in this regard, the Nakheel sukuk was being confused by the hedge funds as an ordinary bond, when actually the terms of the sukuk were quite different. The sukuk issuance was, by nature of its Islamic structure backed by an asset, in this case land (Nakheel's proposed Dubai Waterfront mega development near Jebel Ali port). In the case of non-payment, holders could lay claim to the specific asset that backed the sukuk, but not other Dubai World or Nakheel assets (e.g., hotels or other property in the U.S.) (Comment: ForeQ ownership of land is highly contentious in the UAE. It is hard to imagine the Dubai or UAE Federal governments allowing a hedge fund or other international beneficiaries of a Nakheel default, to actually take control of this particular asset End Comment.)

¶7. (C) Director of Funds Management Abedin claimed in the December 6 conversation with Consul General and Econoff that the sukuks issued by Nakheel were originally intended for a domestic investor class and not for foreign based investors. Foreign investors "erroneously" assumed Dubai World's commercial debts would be backed by a sovereign guarantee rather than the specified assets that by definition underpin a sukuk issuance. (Comment: Clearly, when Nakheel conceived of its sukuks, it did not plan for or expect to begin dealing with the hedge funds, and Dubai authorities continue to struggle to understand how to deal with that community. Local fears have been stoked by press reports that hedge fund holders of the Nakheel sukuk are pushing for a default on the December 2009 sukuk in order to lay claim to assets spread throughout the Dubai, Inc. firmament. One senior Emirati banker told Consul General that the "coup de grace" in terms of shame for Dubai would be a U.S.-based creditor successfully seizing an Emirates airlines plane or other recognizable Dubai asset as part of a Nakheel default End Comment.)

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MIGHT DUBAI WORLD PAY ON TIME AFTER ALL?

¶8. (C) Accompanying the statements from Dubai officials differentiating between sovereign and private debt have been several hints that Dubai World may not go into technical default on its December USD 3.52 billion sukuk re-payment. Shaibani indicated that Dubai World's negotiations with banks were proceeding well. This was echoed in a December 9 conversation with Dubai Financial Market Executive Chairman Essa Kazim who told CG and Pol/Econ chief that international banks were reportedly coming to the table with Dubai World due to longer-term confidence in Dubai not shared or seen as relevant by the hedge fund-holders of short term paper. Those with

longer-term expectations in Dubai had an interest to help the companies restructure and renegotiate repayment terms, while the short-term holders had a greater interest in default in order to lay claim to assets, he said. Finally, Finance Chief Al Saleh emphasized to CG and Econoff December 6 that the Dubai government would "support" Dubai World as it went through its restructuring. DFM's Kazim sketched out a scenario whereby Dubai World successfully renegotiates extended terms on its large debt obligations with the local banks that reportedly hold 75 percent of its debt, with the Dubai government later stepping in to cover the costs associated with buying up the short-term notes from the hedge fund community, possibly using the USD 5 billion raised from Abu Dhabi in the days prior to the Dubai World standstill announcement.

COMMENT

19. (C) The Dubai government is determined to protect its sovereign holdings and those of the ruling Maktoum family. Second, it seeks to "ring fence" prized assets within the Dubai World and other government related entities portfolios while simultaneously seeking to renegotiate and extend debt maturity dates with the local and international banking community. Whether these steps will succeed in seeing the Emirate through the coming period without significant assistance from Abu Dhabi remains to be seen. We still lack clear data on the government's ability to meet its own obligations, despite the assurances from its senior financial managers. Certainly, markets are not yet convinced, as evidenced in significant market drops in the past several days of Dubai trading, and the credit downgrades of government bodies like the Dubai Water and Electricity Authority. The recent appointment of outside restructuring experts is hoped to bring credibility to the restructuring of Dubai World, but still does not address the broader, and quite confused, mix of government and private liabilities. The coming weeks should provide a clear signal of the success of the government's current strategy, once the Nakheel sukuk repayment deadline passes (December 14, but with a two-week grace built in). END COMMENT
SIBERELL